Archwilydd Cyffredinol Cymru
Auditor General for Wales

Financial Resilience Assessment

Denbighshire County Council

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Status of report

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This report has been prepared on behalf of the Auditor General for Wales by Gwilym Bury, Gareth Evans, Jeremy Evans, Fflur Jones, Gareth Evans, and Anthony Veale under the direction of Jane Holownia.

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The Council has appropriate financial management arrangements but needs to strengthen its approach to income generation.

Summary report

Summary

1. Good financial management is essential for the effective stewardship of public money and the delivery of efficient public services. Good financial management:
   - helps authorities take the right decisions for the short, medium and long term;
   - helps authorities deliver services to meet statutory obligations and the needs of local communities;
   - is essential for good corporate governance;
   - is about managing performance and achieving strategic objectives as much as it is about managing money;
   - underpins service quality and improvement;
   - is the basis of accountability to stakeholders for the stewardship and use of resources; and
   - is a key management discipline.
2. Long-term financial management is not about predicting the future; it is about preparing for it. Authorities need to understand future demand, assess the impact of probable changes, review the gap between funding needs and possible income, and develop appropriate savings strategies.
3. Well-considered and detailed long-term financial strategies and medium-term financial plans can ensure the delivery of strategic priorities by enabling appropriate financial choices. Conversely, short-term annual budget planning alone encourages an incremental and process-driven approach that can be ineffective in a period of rapid external change.
4. Financial resilience is achieved when an authority has robust systems and processes to effectively manage its financial risks and opportunities, and to secure a stable financial position.
5. Given the continuing pressures on funding, we have considered whether the authority has appropriate arrangements to plan to secure and maintain its financial resilience in the medium term (typically three to five years ahead). While there may be more certainty for the authority over an annual cycle, financial pressures impact beyond the current settlement period. We have considered evidence of the authority's approach to managing its finances in the recent past and over the medium term when reaching our view on the authority's financial resilience.
6. We undertook our assessment during the period May to October 2015, and followed up issues highlighted in the 2014-15 financial position work. The focus of the work was on the delivery of 2014-15 savings plans, and the 2015-16 financial planning period.

7. The work focused on answering the following question: **Is Denbighshire County Council (the Council) managing budget reductions effectively to ensure financial resilience?** In this report we also consider whether:

- **financial planning arrangements effectively support financial resilience;**
- **financial control effectively supports financial resilience; and**
- **financial governance effectively supports financial resilience.**

8. Overall we concluded that the Council has appropriate financial management arrangements but needs to strengthen its approach to income generation. We came to this conclusion based on our findings in relation to financial planning, financial control, and financial governance arrangements.

9. This report gives a risk rating for each aspect: financial planning, financial control and financial governance. The descriptors for risk ratings are set out below.

Low risk	Arrangements are adequate (or better) with few shortcomings in systems, process or information. Impact on the authority's ability to deliver its financial plan may be minimal.
Medium risk	There are some shortcomings in systems, process or information that may affect the authority's ability to deliver the desired outcomes of its financial plan.
High risk	There are significant shortcomings in systems, process or information and/or there is a real risk of the authority's financial plan not delivering the desired outcomes.

10. We rate the risk to the Council's delivery of its financial plan for each of these elements as follows.

Low risk	Financial planning
Medium risk	Financial control
Low risk	Financial governance

11. As well as drawing conclusions on financial planning, control and governance, Appendix 1 sets out the Council's performance against some key financial indicators. No conclusion is intended to be drawn from these indicators, however, they are an important consideration in financial strategy and planning and provide useful context. The key financial indicators are:

- **budgetary performance** – reviewing the history of spending against revenue budgets and an assessment of whether the balance sheet has remained healthy;
- the level of useable **reserves** providing sufficient cover for any future slippage on revenue expenditure, and whether school balances are being maintained and any school deficits managed;

- gearing – long-term **borrowing** is linked to the value of property plant and equipment;
- **liquidity** – an analysis of whether there are sufficient current assets available to cover short-term liabilities and working capital requirements and whether the liquidity position has declined as a result of the gearing policy adopted; and
- **workforce** data such as staff numbers, use and costs of agency staff and sickness absence performance.

12. Our April 2015 national report **The financial resilience of councils in Wales** was based on fieldwork carried out in all Welsh local authorities. From this work, and from other available material related to aspects of financial management, we have drawn together some key characteristics of good practice to assist practitioners in developing their arrangements. These characteristics can be found in Appendix 2.

Recommendations/proposals for improvement

13. Here is the following proposal for improvement arising from this review.

Income generation and charging	
P1	Establish a formal policy on income generation and charging and a register of the charges set by departments.

Detailed report

The Council has appropriate financial management arrangements but needs to strengthen its approach to income generation

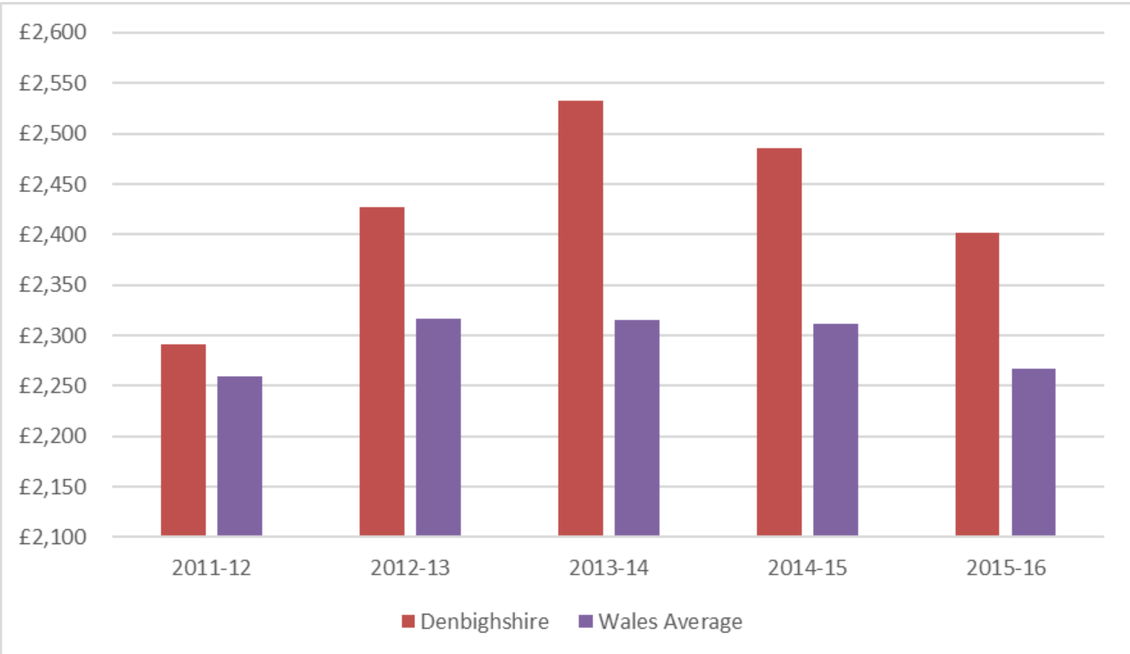
Financial planning

The Council's future plans and arrangements to deliver savings are fit for purpose and are being effectively managed

14. Local government in Wales receives the bulk of its funding through what is known as Aggregate External Finance (AEF). Comparing AEF across the period 2010-11 to 2014-15 is complicated for two main reasons. Firstly, the Welsh Government has incorporated into AEF grants that were previously provided separately. The picture is further complicated by the devolution of council tax benefit, which has been incorporated into the AEF. Having considered this, we estimate that there has in fact been a real-terms reduction in funding to Welsh local authorities by the Welsh Government of £464 million (10 per cent) between 2010-11 and 2014-15.

15. Exhibit 1 below compares the Council's planned gross revenue expenditure (net of income) per head of population over the last five years with the average for councils across Wales.

Exhibit 1



Source: Stats Wales

16. The graph shows that expenditure per head in Denbighshire was well above the Wales average in each of the four years prior to 2015-16. This reflects mainly the factors such as deprivation and rurality that influence the Welsh Government's distribution formula for Revenue Support Grant. However, the 2011 Census also revealed that previous population projections, on which funding levels had been based, had over-estimated the population of Denbighshire. As a result, expenditure per head appears to have increased by significantly more than the increase in the Wales average since 2012-13. Since 2011-12, we calculate that spend per head has increased by three per cent in real terms in Denbighshire compared with an average three per cent reduction across Wales (with 2014-15 as the last year of data).

17. There is an effective corporate framework for financial planning at the Council. Its overall vision and aims are clearly articulated through its Corporate Plan 2012-17 which details the seven improvement objectives the Council aims to achieve for its citizens. The Council has a robust mechanism in place for ensuring improvement objectives are linked to, and protected by, service plans and that budgets and financial plans are set in line with the delivery of these objectives. Progress is measured through the Council's performance monitoring framework and is reported each year through the Council's Annual Delivery Document.

18. There are a number of policies supporting the Council's financial planning arrangements, with responsibilities set out in respect of budget setting, monitoring and reporting. The Council has a Medium Term Financial Plan (MTFP) which is currently in the process of being updated. The 2014 version sets out how the remaining savings gap is to be addressed in 2015-16 and beyond.

19. The Council's approach to setting its revenue budget changed for the 2015-16 financial year. While previously the Council approach has been to reduce costs incrementally, for 2015-16, services were reviewed under a Freedoms and Flexibilities programme to achieve a target of £18 million savings over the next two years. This budget process focuses on what a service does and how much it costs, and attempts to analyse whether service provision is statutory, aligned to a corporate priority or discretionary.

Financial control

The Authority has effective controls in place to ensure its financial processes and management are robust, but needs to strengthen its approach to income generation

20. The Council's 2015-16 savings and efficiencies plans are being effectively managed and are likely to be achieved. Despite a very challenging grant settlement from the Welsh Government, the Council set a balanced budget for 2015-16 by identifying savings of £7.3 million, increasing Council Tax by 2.75 per cent and funding the remaining shortfall of £0.5 million from general balances.

21. Efficiency savings plans had been developed for 2015-16 across all Council departments. The plans include clear descriptions of where savings would be made.

22. Denbighshire's savings plan is specific, measurable, achievable, relevant and timely. Over the last three years, over 90 per cent of the required savings were achieved by the end of the second quarter. Monthly budget reports are presented to the Cabinet together with reports on any shortfall in savings. The Council's 2015-16 Savings Plan takes appropriate and relevant account of the future financial pressures the Council faces. Assumptions made by the Council in identifying the shortfall were comprehensive and reasonable and were supported by robust data..

23. Each year the Council reviews its level of reserves and provisions in respect of both earmarked and general reserves, a process which has been incorporated into the budget setting processes and member workshops. This process should also be formally completed at the year-end accounts. There is an inconsistency between the strategy for reserves as set out in the MTFP 2014-18 and the approach to reserves taken in setting the budget for 2015-16.
There is a need to address this disconnect to ensure the Council's approach is consistent and that its key policies and procedures align effectively.

24. The Council also do not currently have a formal policy on income generation/charging, neither do they have a register of the charges set by respective departments. Although some discussion around charging takes place during the budget-setting process, these are not consistent across services and need to be formalised to ensure the Council has a prudent and considered approach. In our 2015 report **Supporting the Independence of Older People: Are Councils Doing Enough?** we highlighted that where there was an absence of income generation policies there is a greater risk that councils are changing services without fully assessing the potential impact on, for example, older people, which undermines their ability to fully meet the Public Sector Equality Duty.

Financial governance

The Council has robust arrangements for reviewing and challenging financial performance and those responsible for managing financial performance are held to account

25. In the last year a few senior officers with financial responsibility have gained promotion and in order to maintain investment into and effective delivery of financial responsibilities the Council needs to ensure that capacity within the Finance service remains adequate.

26. There is a robust framework for reviewing and challenging financial performance at the Council. The Council's new forecasting monitoring and reporting system, 'Collaborative Planning', is effective in ensuring a consistent approach to budgetary control across the Council. As we reported in our last Annual Improvement Report 'Collaborative

Planning' ensures a more consistent approach to budgetary control across the Council by collating budgetary information onto an online system and reducing the need for the use of various spreadsheets within different service departments.

27. The Cabinet receives a monthly budget report. The report shows the projected outturn for the year (rather than the position at a particular point in time) compared to the original budget. The monthly reports contain details of any significant variation in spend coupled with corrective action.

Appendix 1

Performance against key financial indicators

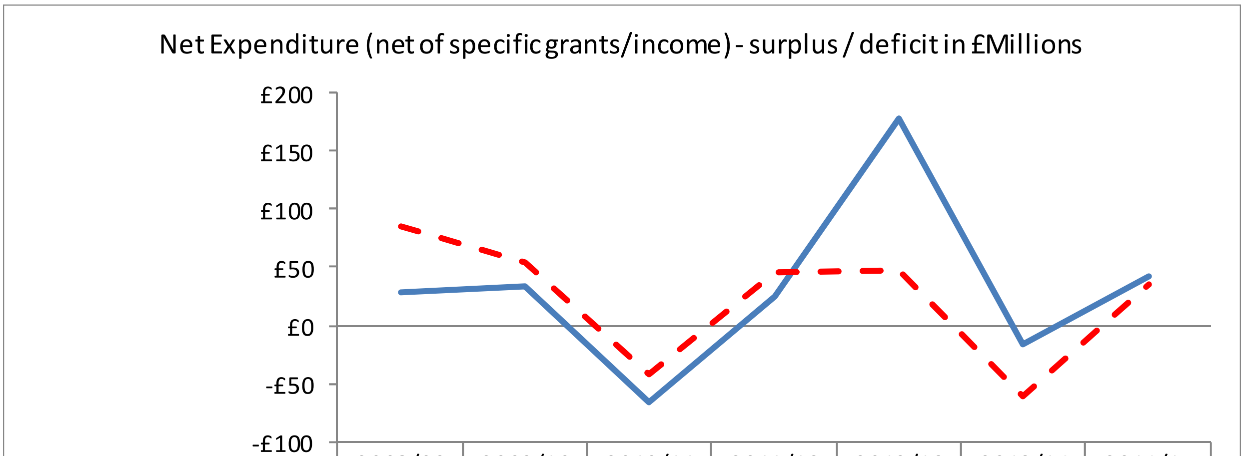
The use of key financial indicators within medium term financial planning provides insight into the effectiveness of financial management arrangements and financial resilience, particularly for important issues such as liquidity, gearing, return on investments and borrowing levels. As part of our financial resilience work we have collated data from the Council's own statement of accounts and also used data from the Welsh Government.

Performance against budget

We looked at the history of underspends or overspends against revenue budgets and performance on the outturn of net revenue expenditure. This helps validate both the strength of planning arrangements and the effectiveness of financial control. A good track-record of delivering expenditure and savings in line with the approved budget is a strong indicator of whether future financial plans, including large savings, can be delivered.

Councils that continue to deliver revenue budget overspends in demand-led services, such as adult and children's social care, are likely to face financial difficulties in the future. Councils are performing well when they have minimised net budget deficit (or achieved a slight surplus) and delivered a favourable net out-turn position. The following indicators are useful to understand performance.

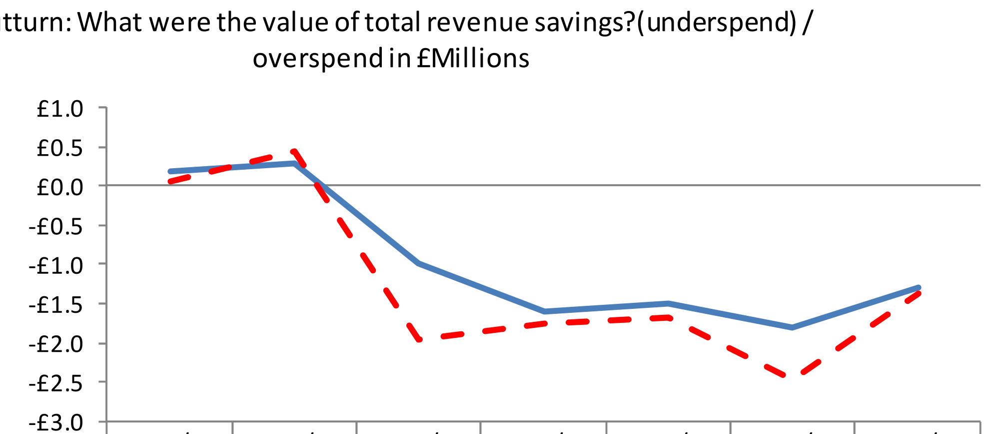
Appendix 1, Figure 1: Net (surplus)/deficit on income and expenditure



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	27.906	33.709	-65.422	25.712	178.783	-16.017	41.745
Average for Wales	84.525	54.55	-41.608	46.083	47.495	-60.869	35.983

Appendix 1, Figure 2: The value of total revenue savings?

An underspend is shown as negative; an overspend is shown as a positive

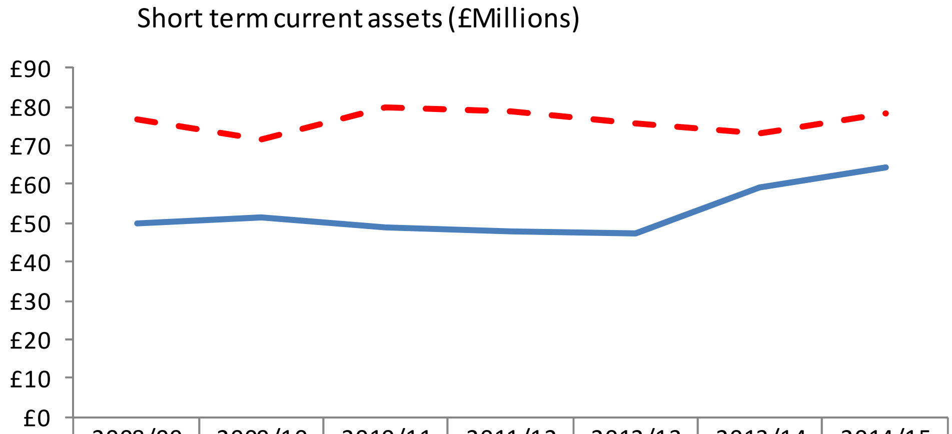


	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	0.191	0.295	-0.998	-1.6	-1.5	-1.8	-1.3
Average for Wales	0.055	0.433	-1.953	-1.75	-1.674	-2.462	-1.384

Liquidity (Short-term current assets divided by short-term current liabilities)

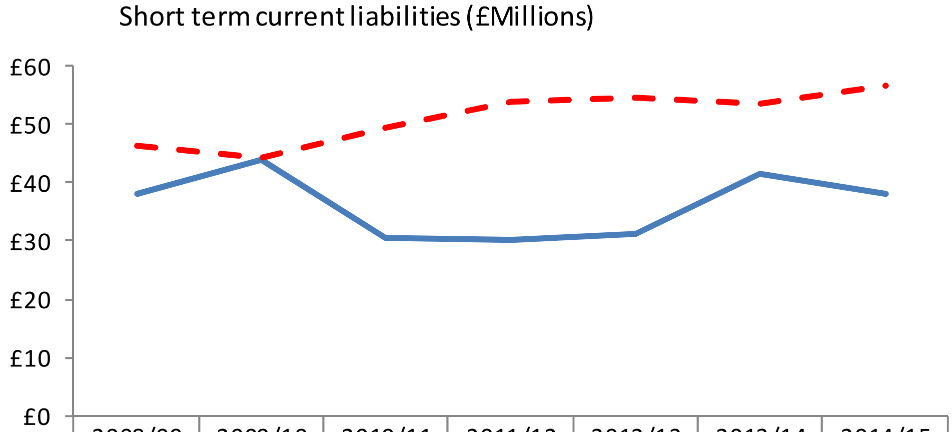
This indicator determines whether there are sufficient assets to cover short-term liabilities. The 'current ratio' of assets (assets that are readily convertible to cash) to liabilities (short-term liabilities that require prompt payment) gives an indication of liquidity. Liquidity is important as it provides an indication of how easy it is to convert assets to cash in a short period of time, which gives the owner of the asset greater financial freedom.

Appendix 1, Figure 3: Short-term current assets in £ Millions



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	50.0	51.6	48.9	48.0	47.2	59.3	64.5
Average for Wales	76.7	71.3	79.9	78.7	75.9	72.9	78.1

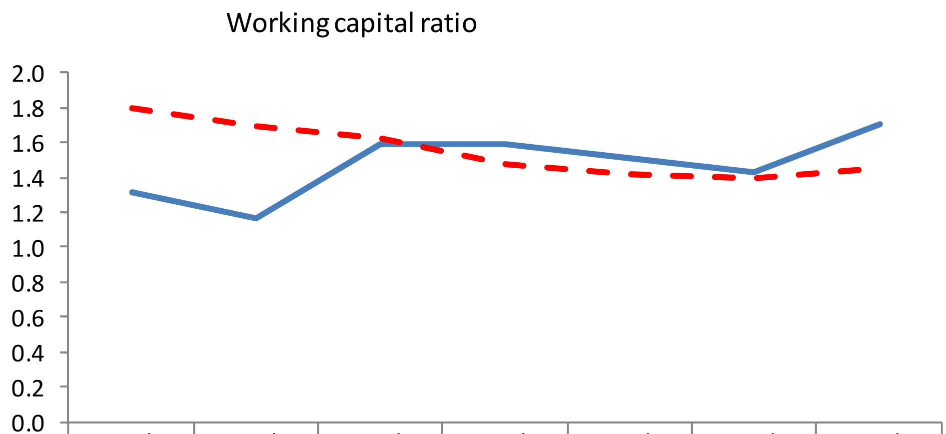
Appendix 1, Figure 4: Short-term current liabilities in £ Millions



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	38.04	43.98	30.66	30.24	31.18	41.54	37.91
Average for Wales	46.37	44.39	49.27	53.84	54.48	53.48	56.70

The working capital ratio is calculated by dividing the short term current assets by short-term current liabilities. Any ratio below 1:1 is very poor and ideally should be above 1.5 to provide a suitable buffer to cover working capital needs. A working capital ratio value of less than 1:1 suggests that the Council will have liquidity problems in the future, while a ratio in the vicinity of 1:5 or higher represents good short-term liquidity.

Appendix 1, Figure 5: Working capital ratio



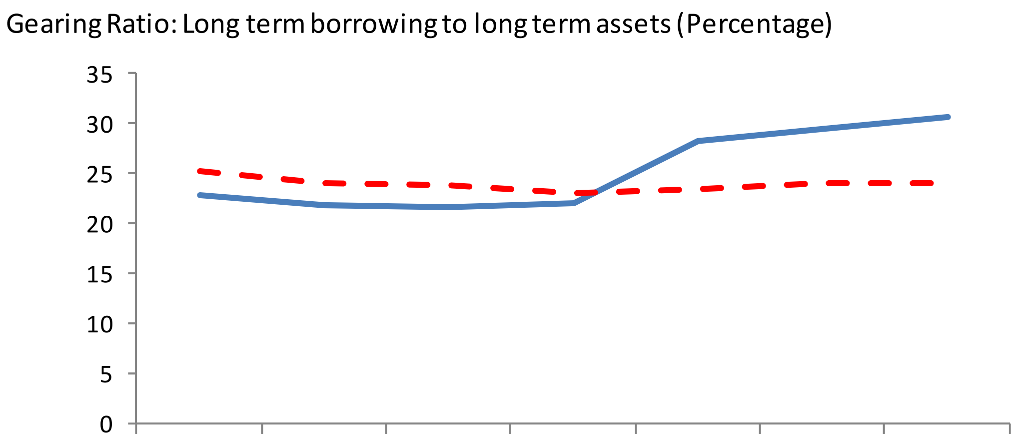
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	1.32	1.17	1.59	1.59	1.51	1.43	1.7
Average for Wales	1.8	1.69	1.63	1.48	1.42	1.4	1.45

Borrowing

This indicator looks at long-term borrowing (Figure 7) as a proportion of long-term assets (Figure 8). This is known as the ‘gearing ratio’.

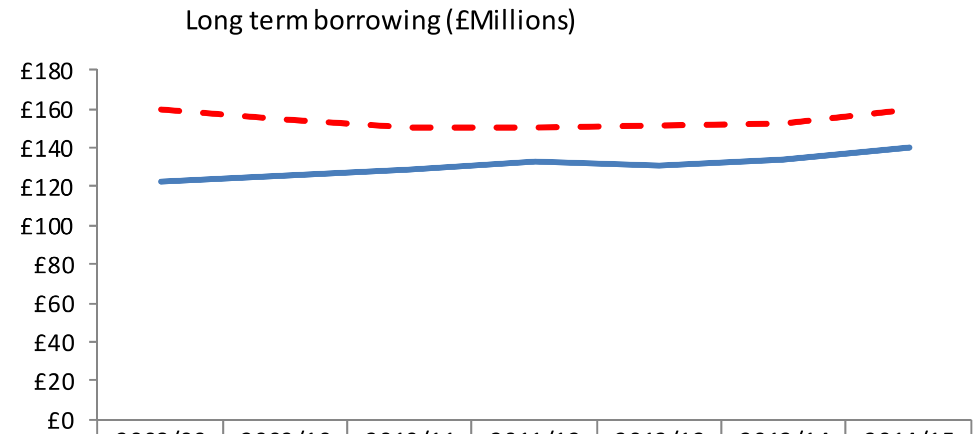
A low gearing ratio indicates that a council is financially stable and can generally borrow more freely as it will be better placed to pay the interest than those with higher ratios. Gearing is therefore a useful measure of corporate financial health as it allows a comparison between council funds and borrowed ‘debt’. Gearing should generally be around 25 per cent unless liquidity (shown in Figure 5) is very strong. The gearing ratio data for Denbighshire includes borrowing to meet the Welsh Housing Quality Standard which is only a factor for those councils in Wales where tenants voted to remain with the Council as its landlord.

Appendix 1, Figure 6: Gearing Ratio, long-term borrowing as a percentage of long-term assets



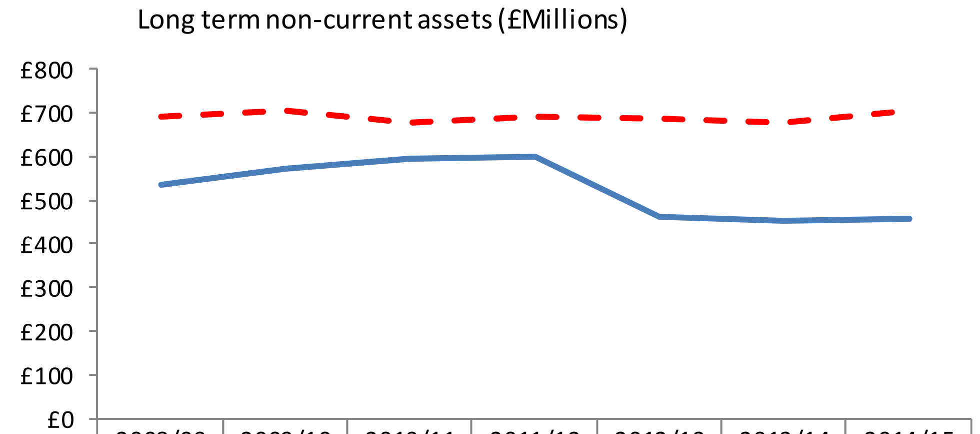
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	22.9	21.9	21.6	22.1	28.3	29.5	30.6
Average for Wales	25.3	23.9	23.9	23.1	23.4	23.9	24.1

Appendix 1, Figure 7: Long-term borrowing in £ Millions



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	122.6	125.3	129.1	132.4	130.8	134.1	140.2
Average for Wales	159.4	154.8	150.3	150.0	151.3	152.4	159.4

Appendix 1, Figure 8: Long-term non-current assets in £ Millions



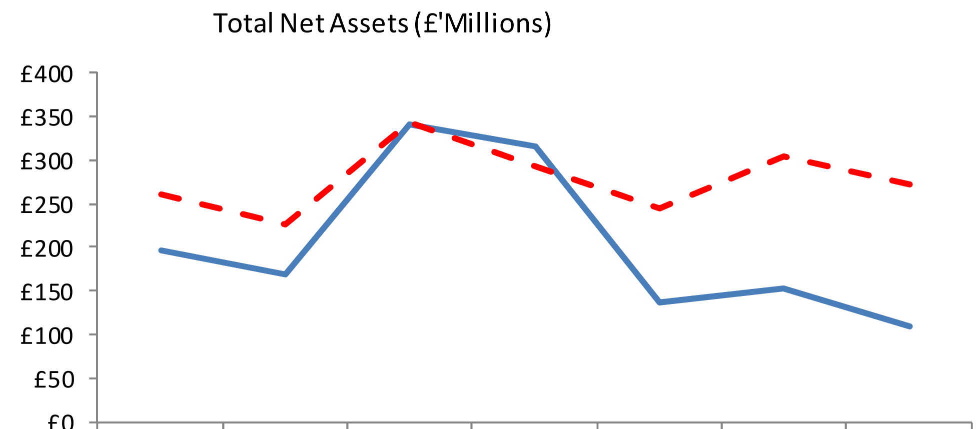
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	535.29	572.00	596.82	599.24	462.56	454.48	458.42
Average for Wales	693.19	705.24	677.25	689.41	686.82	678.41	705.40

Reserves

Net assets/liabilities

This indicator examines the net position of total assets and total liabilities; and ensures they agree to the total of reserves. A net liability is a sign of very poor financial standing. Total Net Assets includes: Short-term current assets, Long-term non-current assets, Short-term current liabilities, Long-term borrowing and other long-term non-current liabilities.

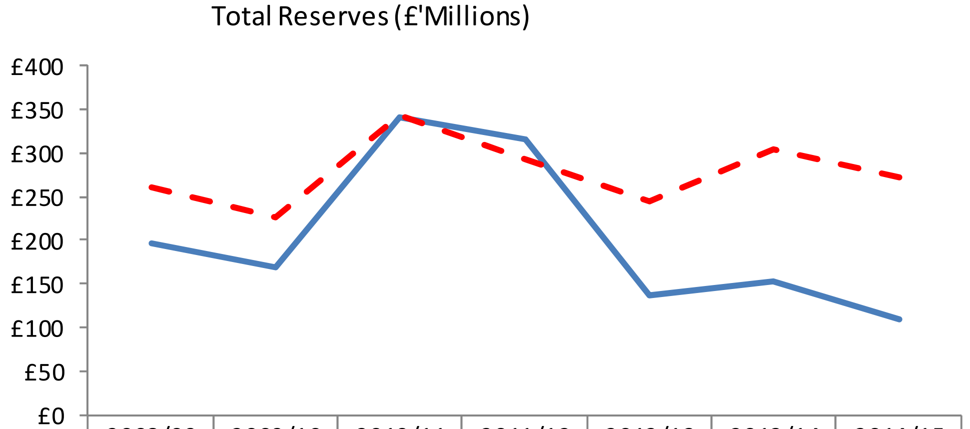
Appendix 1, Figure 9: Total Net Assets in £ Millions



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	196.246	169.255	340.698	314.986	136.203	152.17	110.425
Average for Wales	261.842	225.2	343.366	293.34	244.806	304.82	271.931

Total reserves includes: General Fund, Earmarked Reserves, School Balances, Other Useable Reserves and Unuseable Reserves.

Appendix 1, Figure 10: Total Reserves in £ Millions

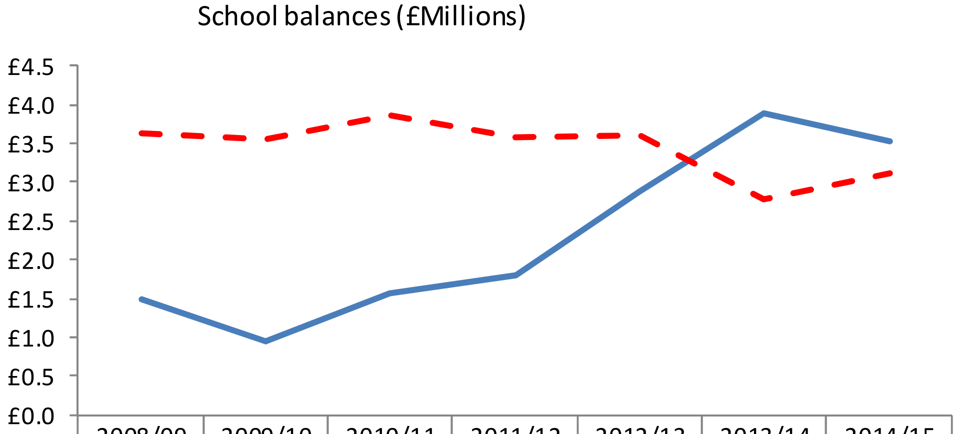


	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	196.246	169.255	340.698	314.986	136.203	152.170	110.425
Average for Wales	261.842	225.200	343.366	293.340	244.806	304.817	271.931

School balances (Council-run schools only)

This indicator examines whether net school balances are being maintained with deficits. School balances form part of useable earmarked reserves on the balance sheet and have been extracted from the notes to the accounts which show the movements during the year.

Appendix 1, Figure 11: School Balance Reserves in £ Millions

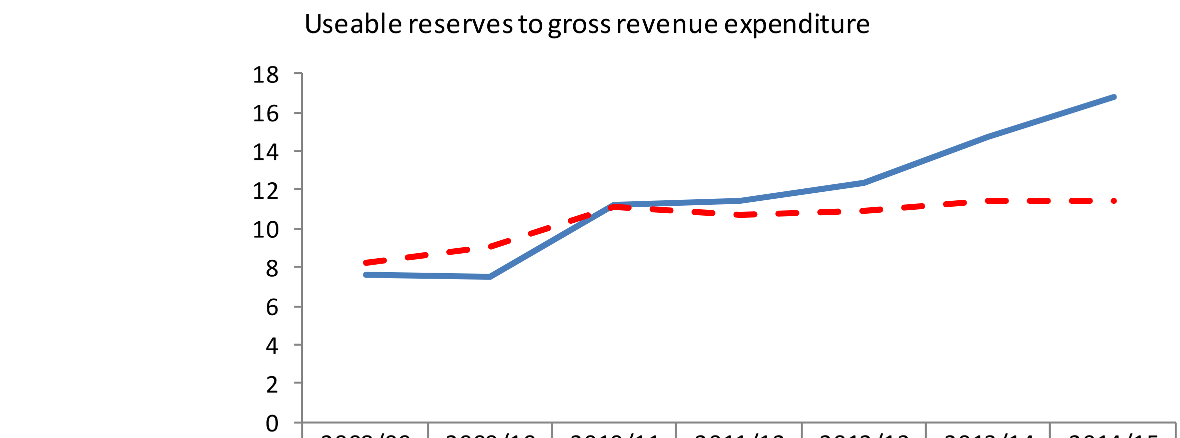


	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	1.50	0.94	1.58	1.80	2.87	3.89	3.54
Average for Wales	3.63	3.56	3.87	3.58	3.60	2.77	3.11

Useable reserves

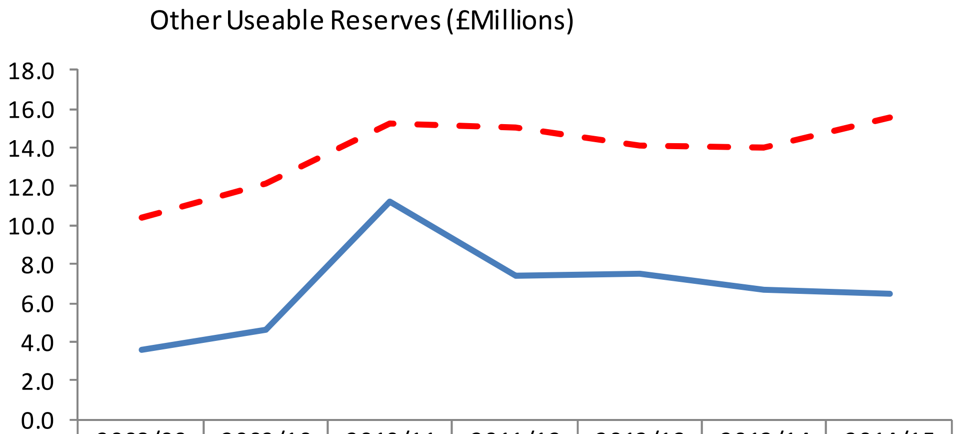
The indicator used here is, ‘Total usable reserves as a percentage of Gross Revenue Expenditure’. This includes ‘General Fund’ and earmarked reserves. The total of useable reserves is divided by total Gross Expenditure, and provides a ratio which shows the buffer available to cover future spend. Anything above 10 per cent is a good indicator of reserve strength. However, this does not mean that levels below this indicate weakness either. Councils should consider and agree an appropriate level of reserves for their own circumstance, based on recommendation from the s151 officer.

Appendix 1, Figure 12: Useable Reserves as a percentage of Gross Revenue Expenditure



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	7.6	7.5	11.2	11.4	12.4	14.7	16.8
Average for Wales	8.2	9.1	11.1	10.7	10.9	11.4	11.4

Appendix 1, Figure 13: Useable Reserves in £ Millions



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Denbighshire	3.563	4.57	11.201	7.4	7.47	6.727	6.502
Average for Wales	10.38	12.147	15.213	15.006	14.09	14.007	15.57

Appendix 2

Key characteristics

Key characteristics of good financial planning
The authority's budget is set in the context of a longer-term financial strategy and a medium-term financial plan covering a three- to five-year horizon.
The authority has clearly identified the savings it intends to make over a three- to five-year term. The savings plan is underpinned by detailed costings and delivery plans for individual savings (including transformation/change savings).
The authority has a good track record of delivering on its savings plans.
The authority gives due regard to its ability to deliver its statutory responsibilities when considering its short-, medium- and long-term financial plans.
Medium-term financial planning and annual budgeting reflect the authority's strategic objectives and priorities for the year, and over the longer term.
Assumptions around inflation, income levels, demographics, future demand for services and the costs of delivering services are modelled and based on reasonable predictions.
The authority understands its sources of income and the risks arising from these, and has reviewed its approach to fees and charges to ensure it achieves value for money.
Financial and corporate planning processes are integrated, link to risk management arrangements, and incorporate strategic planning for other resources including the capital programme and workforce planning.
The authority uses financial modelling to assess likely impacts on financial plans and required savings for different scenarios, and to help ensure short-term fixes are not achieved at the expense of long-term sustainability.
The authority models key expenditure drivers (for example, population changes and demand for services), sources of income (for example, income and government grant forecasts), revenue consequences of capital and resource requirements and balances.
The authority operates within a level of reserves and balances (including earmarked reserves and the general fund balance), approved by members, and appropriate to the strategic, operational and financial risks it faces.
If the authority is not at its target level for balances, there is planned action in place to achieve this, taking account of any associated risks to the organisation's financial position and delivery of its priorities.

Key characteristics of good financial control
The authority has an appropriate and effective budget management policy that clearly sets out roles, responsibilities and accountability. The scheme of delegation is clear, and processes are set out to manage budget under and overspends.
Financial monitoring and forecasting is fit for purpose and accruals based, helping to ensure a clear link between the budget, in-year forecasts and year-end position.
The authority analyses and extrapolates relevant trends, and considers their impact on the projected final out-turn.
The authority takes timely action to address any budget pressures, for example by taking corrective action to manage unfavourable variances or by revisiting corporate priorities.
The authority has a good recent record of operating within its budget with no significant overspends.
The authority has agreed a clear policy on the use of its reserves. There is a clearly justified minimum level for its 'general fund' reserves balance. There is a clear rationale to explain transfer from, or between, reserves. Clear protocols explain how and when each reserve should be used. Decisions about reserves are underpinned by a comprehensive assessment of risk and current performance.
The reserves policy has been agreed by members and subject to scrutiny.
The authority has a clear policy on income generation/charging. There is a register of charges across its services to help manage charges consistently. The authority has corporate guidelines on how concessions should be applied. Charges are regularly reviewed and the policy updated.
The authority sets and monitors challenging targets for the collection of material categories of income and arrears based on age profile of debt. Where targets are not being met, appropriate corrective action is taken during the year to achieve the targets.
The authority does not write off significant levels of debt as uncollectable.
The authority monitors its key financial ratios, benchmarks them against similar bodies and takes action as appropriate.
The annual governance statement gives a true reflection of the authority.

Key characteristics of good financial governance
The leadership team clearly understands the significant and rapidly changing financial management challenges and risks facing the organisation, and is taking appropriate action to secure a stable financial position.
The chief financial officer is a key member of the leadership team, being actively involved in all business decisions, and promoting and delivering good financial management.
The leadership team fosters an environment where there is good understanding and routine challenge of financial assumptions and performance, and a culture of transparency about the financial position.
The leadership team considers the financial skills required for different tiers of management and staff throughout the organisation, and actively develops financial literacy and skills.
The leadership team provides constructive scrutiny and challenge on financial matters to ensure arrangements remain robust and fit for purpose.
There is regular and transparent reporting to members. Reports include detail of action planning and variance analysis.
Members scrutinise and challenge financial performance effectively, holding officers to account.
The authority has an objective, knowledgeable and effective audit committee that provides effective challenge across the authority and assurance on the arrangements for risk management, maintaining effective internal control, and reporting on financial and other performance.
Internal and external audit recommendations are dealt with effectively and in a timely manner.
There is effective engagement with stakeholders on budget issues, including public consultations.

Wales Audit Office
24 Cathedral Road
Cardiff CF11 9LJ

Tel: 029 2032 0500
Fax: 029 2032 0600
Textphone: 029 2032 0660

E-mail: info@audit.wales
Website: www.audit.wales

Swyddfa Archwilio Cymru
24 Heol y Gadeirlan
Caerdydd CF11 9LJ

Ffôn: 029 2032 0500
Ffacs: 029 2032 0600
Ffôn Testun: 029 2032 0660

E-bost: post@archwilio.cymru
Gwefan: www.archwilio.cymru